Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY07 Q3

In general, the acute hospital industry's financial performance improved during the third quarter of Fiscal Year 2007 (FY07 Q3) compared to the third quarter of Fiscal Year 2006 (FY06 Q3). Hospital industry profitability improved from FY06 Q3 levels, mostly attributable to operating margin performance. In addition, fewer hospitals showed total losses in FY07 Q3. Most hospitals (86%) continued to comfortably meet short-term obligations. Days in accounts receivable and average payment period remained stable. Solvency also improved; however, the ability to cover long-term obligations remained a concern for 25% of Massachusetts acute hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes acute hospital financial reports in response to a legislative mandate to provide an assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to inform and protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis from FY03 through FY07 Q3.[1] Financial trends for individual hospitals are available on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

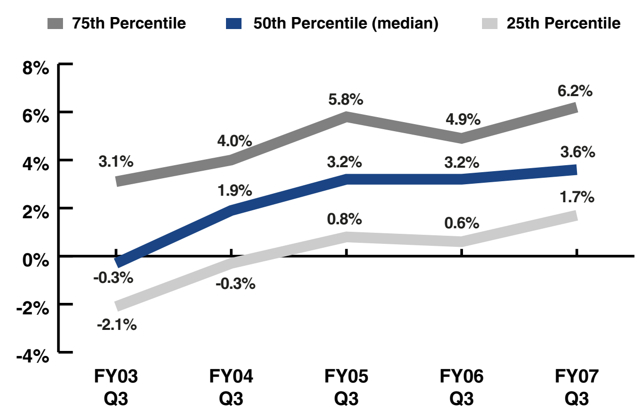
Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis and discussed in this report are profitability, liquidity, and solvency.[2] In addition, we present these three areas by hospital teaching status.

Profitability

Although most Massachusetts acute care hospitals are nonprofit, they need to generate a sufficient surplus in order to fulfill their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's

Figure 1

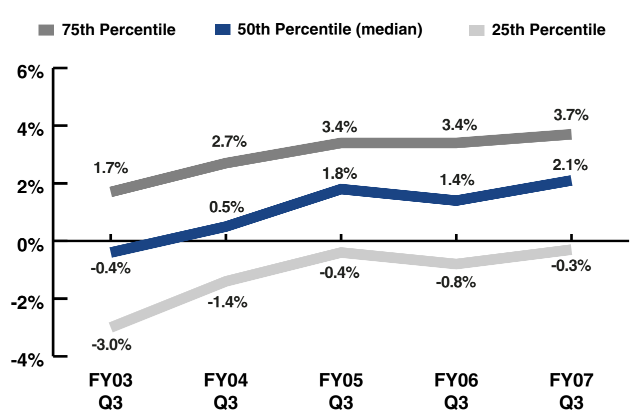
Total Margin Trend, FY03 Q3-FY07 Q3



- **Overall profitability improved in FY07 Q3 primarily due to operating performance, with fewer hospitals experiencing losses.**

Figure 2

Operating Margin Trend, FY03 Q3-FY07 Q3



- **Operating performance improved across the industry in FY07 Q3.**

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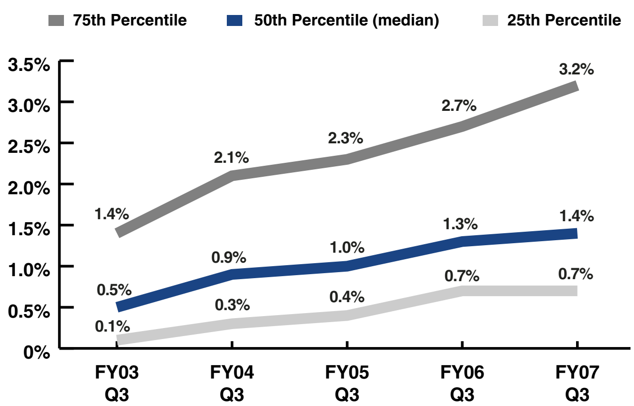
Figure 3

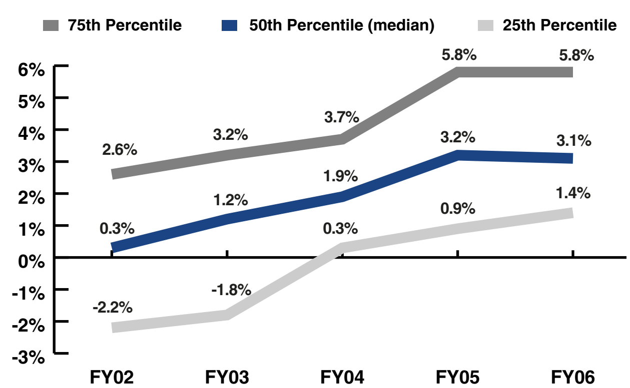
Non-operating Margin Trend, FY03 Q3-FY07 Q3



- **Non-operating Margins increased in the upper quartile and remained stable in the first and second quartiles in FY07 Q3.**

Figure 4

Annual Total Margin, FY02-FY06



- **Annual Margins are provided as a reference.**

profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY03 Q3 through FY07 Q3 trends for 25th, 50th (median), and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

Profitability in FY07 Q3 improved over the third quarter of previous years (see Figures 1and 2). Total margin improved across all three quartiles, primarily due to improvements in operating margins. Operating margins showed marked improvement in FY07 Q3 over FY06 Q3. Non-operating margins remained fairly stable in FY07 Q3 compared with previous third quarters, although there was a noticeable increase in the upper quartile from FY06 Q3 to FY07 Q3. In addition, fewer hospitals (8) showed total losses in FY07 Q3 compared to FY06 Q3 (15 hospitals). For reference, Figure 4 provides annual measures of total profitability.

Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indication of financial stress. Three liquidity ratios are reported here: Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period (APP).[9] Figures 5, 6, and 7 show trends in quartile values for these three ratios.

The ability of the hospitals to meet current obligations remained stable in FY07 Q3 compared with FY06 Q3 (see Figure 5). Most hospitals (86%) performed above the 1.0 minimum benchmark in FY07 Q3.[10] In addition, the industry remained relatively stable in terms of efficient management of Days in Accounts Receivable (Figure 6). Average time to pay current liabilities also showed a slight improvement with decreases across all three quartiles in FY07 Q3 from FY06 (see Figure 7). However, about 34% of hospitals paid current obligations in a shorter time frame than they collected payments, which could lead to cash flow constraints for this group of hospitals in the future.

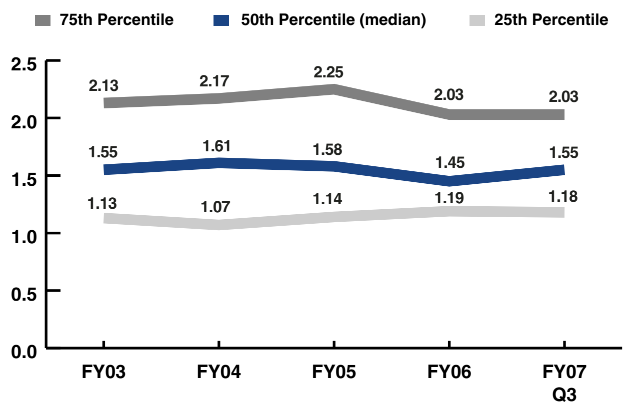
Solvency

Solvency ratios provide information regarding how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. Solvency ratios of Debt Service Coverage and Cash Flow to Total Debt are not included in this report because annualized data are necessary to accurately present these ratios. For quarterly analysis, only one solvency ratio is reported: Equity Financing.[11]

The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the potential for a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition or capital improvements. Equity Financing showed continued improvement across all quartiles in FY07 Q3 from previous years (see Figure 8); however this ratio was below the 30% industry benchmark for 25% of the hospitals, indicating long-term solvency issues for this group.

Figure 5

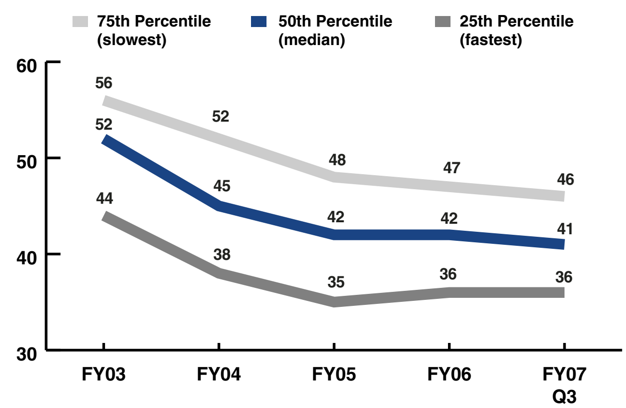
Current Ratio Trend, FY03-FY07 Q3



- Current Ratio remained fairly stable across the industry with slightly improved medians. Most hospitals (86%) maintained Current Ratios above the 1.0 benchmark in FY07 Q3.

Figure 6

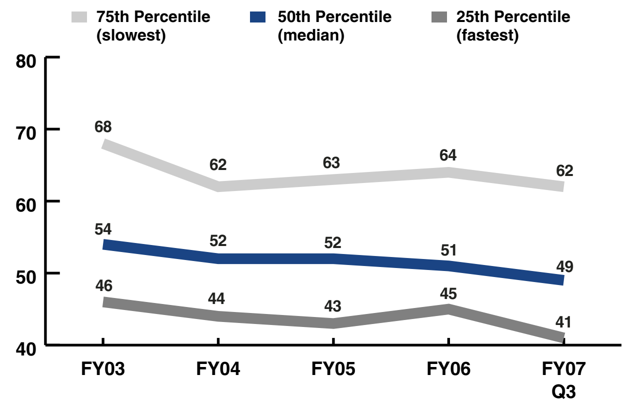
Days in Accounts Receivable Trend, FY03-FY07 Q3



- Massachusetts acute hospitals' average days to collect receivables remained stable across all three quartiles in FY07 Q3.

Figure 7

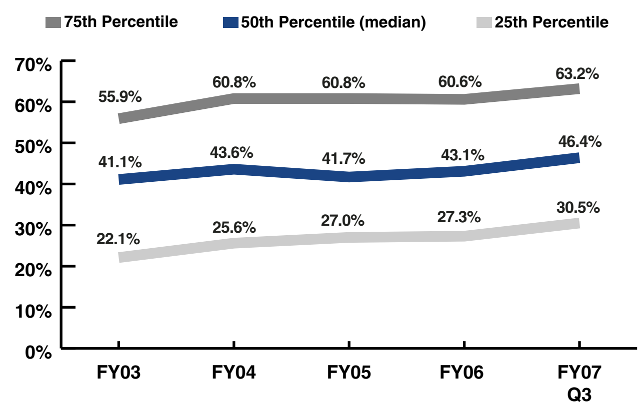
Average Payment Period Trend in Days, FY03-FY07 Q3



- Average Payment Period decreased across all quartiles in FY07 Q3; thirty-four percent of hospitals paid current obligations at a faster rate than they collected receivables.

Figure 8

Equity Financing Trend, FY03-FY07 Q3

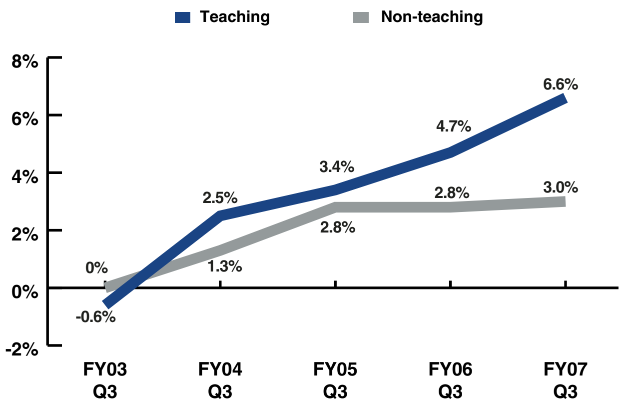


- Equity Financing Ratios improved for most of the industry in FY07 Q3; however, 25% of the hospitals were below the 30% benchmark. The highly leveraged position of some hospitals may make future asset acquisition difficult for this group.

Teaching versus Non-teaching Hospitals[12]

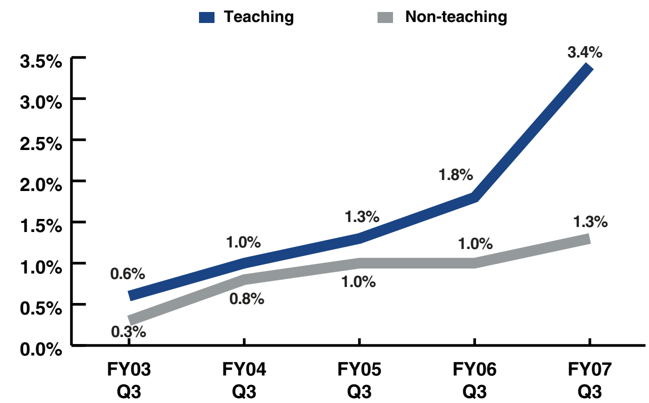
The Division also compares the financial health of teaching and non-teaching hospitals using financial ratio analysis. In terms of total and operating profitability, teaching hospitals outperformed non-teaching hospitals. While none of the teaching hospitals experienced overall losses in FY07 Q3, 16% of non-teaching hospitals had a negative total margin. The median total margins for both teaching and non-teaching hospitals were higher in FY07 Q3 compared with FY06 Q3. Teaching hospitals also experienced a sharper rise over the year than non-teaching hospitals in median total margin (see Figure 9). Teaching hospitals' median non-operating

Figure 9
Median Total Margin, FY03 Q3-FY07 Q3



- **Total margin improved in FY07 Q3 compared with FY06 Q3 for both teaching and non-teaching hospitals.**

Figure 10
Median Non-operating Margin FY03 Q3-FY07 Q3



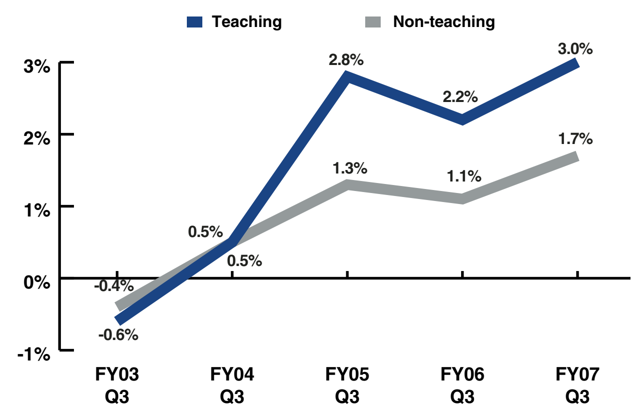
- **Teaching hospitals experienced a notable rise in median non-operating margin from FY06 Q3 to FY07 Q3.**

margins were more than twice as high as those of non-teaching hospitals in FY07 Q3. The median non-operating margin rose significantly in FY07 Q3 for teaching hospitals. For non-teaching hospitals, median non-operating margins improved only slightly (see Figure 10). Teaching hospitals also experienced a significant rise in median operating margin compared to a small improvement for non-teaching hospitals (see Figure 11). The profitability improvement for both types of hospitals was divided fairly evenly between operating and non-operating performance.

Results were mixed with regard to liquidity. Median Current Ratio was roughly equal for teaching hospitals and non-teaching hospitals. In the upper quartile, teaching hospitals were significantly stronger. However, a higher percentage of teaching hospitals (21%) than non-teaching hospitals (12%) experienced Current Ratios below the minimum industry benchmark of 1.0. Non-teaching and teaching hospitals had comparable performance in collecting receivables and paying current obligations. Non-teaching hospitals displayed slightly fewer median days in A/R and median APP. However, 29% of teaching hospitals and 35% of non teaching hospitals had A/R greater than APP, suggesting that teaching hospitals are demonstrating more effective payment management.

Non-teaching hospitals may have more difficulty meeting interest and principal payments in the upcoming year as 29% (versus 7% for teaching hospitals) were below the 30% benchmark for Equity Financing in FY07 Q3. However, this was an improvement over FY06 Q3 when 39% of non-teaching hospitals and 20% of teaching hospitals experienced equity financing ratios below the benchmark.

Figure 11
Median Operating Margin, FY03 Q3-FY07 Q3



- **Median operating margin continued a trend of improvement for both teaching and non-teaching hospitals.**

Summary

Overall profitability improved in FY07 Q3, primarily due to operating performance. Profit levels were higher in FY07 Q3 than they were in FY06 Q3 with fewer hospitals experiencing losses. Current ratios remained fairly stable, with slight improvements. A majority of hospitals (86%) were able to meet their current obligations. In addition, management of receivables remained stable. Finally, solvency improved for most of the industry; however, the ability to cover long-term obligations remained a serious concern for 25% of Massachusetts hospitals.

Financial ratio values for each hospital are on the Hospital Fact Sheets in the Division of Health Care Finance and Policy Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Hospital Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

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[1] The FY07 Q3 findings in this report are based on the financial filings of 65 of 66 acute care hospitals in Massachusetts (Saint Vincent Hospital's data were unavailable and are not included in this report). Most of these hospitals, 61, have a fiscal year ending on September 30, i.e., this report includes nine months of their data. Cambridge Health Alliance, MetroWest Medical Center and Saint Vincent Hospital have a fiscal year ending on June 30. Martha's Vineyard Hospital's fiscal year ends on March 31. Mercy Medical Center's fiscal year ends on December 31.

[2] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[3] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the lower end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the upper end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[4] Ratio of total income to total revenue.

[5] Ratio of operating income to total revenue.

[6] Ratio of non-operating income to total revenue.

[7] Ratio of current assets to current liabilities.

[8] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[9] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[10] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[11] Ratio of total net assets to total assets.

[12] According to the Medicare Payment Advisory Commission (MEDPAC), a major teaching hospital has at least 25 FTE residents per 100 inpatient beds. For this report, teaching status was determined according to the MEDPAC definition and was based on FY06 hospital cost report data submitted to the Division by the hospitals.

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